THE INDEPENDENT VOICE OF THE CABLE TELEVISION INDUSTRY

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OCT 17 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

October 17, 1994

William Caton, Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, DC 20554

DOCKET FILE COPY ORIGINAL

Ex Parte Presentation in Docket 92-266

Dear Mr. Caton:

Enclosed are copies of a letter and attachment delivered to Meredith Jones, Chief of the Cable Television Bureau from Stephen R. Effros, President of the Cable Telecommunications Association. Copies have been delivered to each of the commissioners. This material is in further explanation of a previous communication of September 26, 1994, and deals with the regulatory treatment of small cable systems.

Please associate this material with the record in Docket 92-266.

Sincerely,

Bob Ungar
General Counsel

Enclosure

No. of Copies rec'd 0+1
List ABCDE

CABLE TELECOMMUNICATIONS ASSOCIATION
3950 CHAIN BRIDGE ROAD
P O BOX 1005
FAIRFAX VA 22030-1005
703/691-8875
703/691-8911 FAX

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

October 17, 1994

Meredith Jones
Chief, Cable Services Bureau
Federal Communications Commission
1919 M St. N.W.
Washington, D.C. 20554

Dear Meredith:

Attached, as we discussed, is additional material in support of CATA's proposal for "alternative regulation." As you will see, we believe that alternative regulation, as outlined in our previous memo, is consistent with the Cable Act, and can be implemented without the need for additional rulemaking or new forms.

I hope you find this material helpful. I would be happy to discuss the proposal with you at your convenience.

Sincerely,

Stephen R. Effros

Stephen R. Effros
President

SRE/gve

Enclosure

cc: Chairman Reed E. Hundt
Commissioner Rachelle B. Chong
Commissioner Susan Ness
Commissioner James H. Quello
Commissioner Andrew C. Barrett

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Under the CATA proposal for "alternative regulation," cable systems with fewer than 1000 subscribers would be permitted to enter into negotiations with local franchising authorities to arrive at reasonable rates for all regulated tiers of service. The proposal retains the requirements for certification and the upper tier complaint process, and envisions rate decisions based on a balancing of the factors set forth in the Cable Act of 1992. Franchising authorities would retain the option of regulating according to present Commission rules.

CATA believes that the Commission can adopt the alternative regulation proposal consistent with the Cable Act of 1992. In the Second Order on Reconsideration, the Commission explained that it could not totally exempt small systems from rate regulation because it had a responsibility under the Act to protect all cable subscribers from unreasonable rates. (Second Order on Reconsideration in Docket 92-266, para. 222) The Commission can, however, adopt a <u>different</u> regulatory scheme for small systems, which, with sufficient oversight and safeguards, will comply with the general intent of the Act.

CATA's proposal is intended to apply to systems with fewer than 1000 subscribers, because the Act makes it clear that, in order to relieve administrative burdens, the Commission may treat these systems differently. Also, as we have pointed out previously, although there are many systems in this category, they serve a very few number of subscribers. Alternative

regulation could, however, be applied to larger systems. Implicit in the Commissions decision to permit transition treatment of low-price systems and systems owned by small operators is the finding that the Cable Act would permit the Commission ultimately to determine that such systems warrant continued rate relief. Indeed, the Commission could have a range of regulatory options depending on system size.

It is our view that alternative regulation be set forth as simply as possible. To this end, we would eliminate largely artificial restrictions based on ownership. Alternative regulation can and should apply to small systems regardless of whether they are owned, in whole or in part, by a multiple system operator. The reasons that a system and its franchising authority may wish to use alternative regulation remain the same. Small communities not only have unique characteristics, but also hands-on, responsive local government. Even though some systems may be able to enjoy some cost advantage for programming owned by their multiple system owners, it remains the case that the per-subscriber costs of building, operating and re-building small systems are higher. It is important that these systems also be able to assure some level of future development with the economic certainty that comes from a multi-year rate plan developed with their local franchising authorities.

Any new regulations would have to conform, generally, to the

principles set forth in the Act, and the Act's bifurcated regulatory approach would have to be maintained. The alternative regulation option could be based on the large record already established by the Commission. There are no new forms, and, because the approach is voluntary, no new requirements that must be fulfilled. Notice would not seem an issue. The same record that justified the transition alternatives (themselves, not subjects of specific prior notice) could well justify yet another approach dealing with a similar (and smaller) set of cable systems.

Under the Act, where a system is not subject to effective competition, a local franchising authority may regulate rates charged for the basic tier pursuant to regulations established by the FCC. In establishing these regulations, the FCC is to be guided by various principles: Sec. 3(b)(1): protecting subscribers of any system not subject to effective competition from rates for the basic service tier that exceed the rates that would be charged for the basic service tier if such cable system were subject to effective competition; and Sec 3(b)(2)(A): reducing administrative burdens on subscribers, cable operators, franchising authorities, and the Commission. In addition, the Commission is to establish regulations, taking into account various factors enumerated in the Act, including: the rates of systems subject to effective competition; the costs of providing channels and services provided on the tier; revenues (if any)

received from advertising; franchise fees; a reasonable profit.

In formulating its two sets of regulations in 1993 and 1994, the Commission has engaged in a balancing process, taking all the statutory principles and factors into consideration. CATA maintains that yet another regulatory program can be established for small systems - one that would permit the all important balancing of principles to be determined by those in the best position to do so, the local franchising authorities. For instance, the Commission is to attempt to reduce administrative burdens on cities, operators, subscribers and itself. In establishing a different regulatory program for small systems, the Commission would be giving considerable weight to this principle. In the First Report and Order in this proceeding, the Commission itself noted its concern "about situations where a franchising authority chooses not to file a certification because it knows that it cannot meet certification standards, particularly when it does not have the resources to administer rate regulation or the legal authority to act, but nevertheless believes that rates should be regulated." (First Report and Order in Docket 92-266, para. 55) The present alternative, for the Commission to regulate, merely shifts an administrative burden from the franchising authority to the Commission. Alternative regulation, as proposed by CATA, would reduce the administrative burden for both the franchising authority and the Commission. We note that in the Second Order on Reconsideration

in this docket (para. 225) the Commission rejected a previous CATA proposal -- that it should permit small systems to charge a rate within some percentage of an average national charge -- not because of any legal infirmity, but because the Commission believed that the idea would not be simpler to administer. Alternative regulation, in the cases where it is chosen, provides a direct and simple form of regulation -- one whose ease of administration would be a benefit for all concerned.

Alternative regulation would eliminate the necessity of filling out complicated FCC forms. This has the advantage of not only eliminating a burden for small system cable operators and small community franchising authorities, but also eliminating a burden for the Commission as well. (If telephone calls to CATA are any indication, the Commission must expend considerable staff time answering questions relating to the proper care and feeding of the 1200 series forms.) Moreover, adhering to the rigor of a prescribed process with a myriad of issues will continue to raise issues whose resolution will often require policy statements from the Commission. Even for small systems, the Commission must still be prepared for this work, since some communities wishing to regulate will not choose alternative regulation. But, we suspect, many will, and the result will be less work for the Commission.

As for the principle that regulations be designed to protect

subscribers from rates exceeding rates that would be charged if a system were subject to effective competition, it must be noted that rates for such systems are merely one factor in the seven factors that the Commission is to take into consideration. As the Commission itself has noted, it has had a paucity of cost information available to it, and it intends to seek such information. But the record is certainly sufficient now to reflect certain economic realities of small systems, for instance higher per subscriber costs, and lack of advertising revenues. The Commission may certainly find that, given these unique characteristics of small systems and the unique relationship to the communities they serve, the local franchising authority is in a better position to determine whether rates charged subscribers are reasonable. In its brief to the U.S. Court of Appeals in Time Warner Entertainment Co., L.P. et al., v. FCC, the Commission has explained, "The 1992 Cable Act does not establish a formula for setting rates.

"Although those statutory provisions supply guidance to the Commission, the statute contains no blueprint by which the Commission is to set rates." The Commission goes on to add (in footnote 12) "And no blueprint is expressed or implied by the sentence providing that the 'regulations shall be designed to achieve the goal of protecting subscribers of any cable system that is not subject to effective competition from rates for the basic service tier that exceed the rates that would be charged

for the basic service tier if such cable system were subject to effective competition." [emphasis supplied] The Commission may find, consistent with the Act, that in the case of small cable systems and the small communities they serve, the local franchising authority is best placed to determine that the rates systems charge are reasonable, given their particular circumstances. We emphasize, that should the local franchising authority find that alternative regulation will not result in reasonable rates, it always has the option of adhering to the Commission's methodology.

As part of the balancing process to comply fairly with the various concerns expressed in the Cable Act, it should be noted that it is also an objective of the Act to "ensure that cable operators continue to expand, where economically justified, their capacity and the programs offered over their cable systems." Permitting the long term "rate certainty" we hope to foster with alternative regulation would make it easier for small systems and their franchising authorities to tailor cable rates that would provide sufficient economic certainty to attract investment capital for upgrades. Under the present system, a cable operator is forced into complicated, costly and uncertain cost-of-service proceedings if it feels that rates resulting from the Commission's regulatory scheme will not yield sufficient revenues to finance an expansion of service. If, however, the operator and franchising authority achieve a comfort level with

alternative regulation, a plan for promoting system expansion can be developed to the satisfaction of all concerned. The franchising authority, of course, is directly answerable to its constituents, the cable subscribing public.

As the Commission has recognized, it is uncertain about the economics of small systems. It is not at all clear what a competitive rate would be. This is why the rates for "transition systems" have effectively been frozen at March 31, 1994 levels. But, if the object is to foster competitive rates, then presumably, rather than engaging in a mathematical exercise to derive or approximate competitive rates, the best approach is to foster competition itself. By giving small systems and their communities sufficient economic certainty to finance system upgrades, small systems stand a fighting chance of being able to compete with other multi-channel video providers which are already in the marketplace -- notably, DSS. Without the upgrades, it is more than likely that many such systems will be unable to compete and are threatened with simply going out of business. Then there will certainly be no competition.

More specific elements of the Cable Act must be adhered to regardless of what regulatory approaches are chosen by the Commission. For instance, the Act requires that whatever regulations are prescribed by the Commission, presumably even an alternative regulatory policy, the operator has to establish on

an actual cost basis the price or rate for the installation or lease of equipment and the installation and monthly use of additional outlets. But the Commission has already shown flexibility by permitting small systems to use average costs. It can show further flexibility by permitting franchising authorities and small system cable operators to arrive at unbundled charges without prescribing a format for doing so. The Act would not seem to require more.

Similarly, for any regulation of the basic tier permitted under the Act certification is required. The details are left to the Commission. Of course, any certification filing announcing an intent to follow the Commission's present regulatory scheme would certainly suffice for alternative regulation as well. But the Commission could also determine that notification by the franchising authority of the mutual intention of it and the cable operator to engage in alternative regulation would be sufficient. The notice would have to contain the required representations as to legal authority, the ability to regulate, and processes to provide a reasonable opportunity for interested parties to be heard. This could be done on the franchise authority's letterhead without the need for any new forms. Notice to the operator would be unnecessary since the operator's assent would be a pre-requisite to the process. As specified by the Act, certification would become effective within 30 days.

Upper Tier Regulation

Under the alternative regulation proposal rates for all regulated tiers would be determined by negotiations between the small system cable operator and the local franchising authority. The Cable Act, of course, requires that the Commission determine whether upper tier rates are unreasonable through a complaint process. It would appear that the Commission must assume this responsibility, and CATA believes it should. However, the Commission can make it clear that it will give great weight to decisions arrived at through alternative regulation. A common scenario, for instance, may be where a cable operator and local franchising authority have agreed to a low-cost, or lifeline, basic tier rate, and a somewhat artificially higher upper tier rate. Although the Commission has determined that it will require tier neutrality, under alternative regulation, it would be possible for the Commission to allow such an arrangement to stand. The Commission can find that a local franchising authority in a small (and, quite possibly, poor) community, weighing the benefits of such a scheme, is in the best position to permit it. While the Commission would retain its review function, because under the Act it must, only in the most extreme cases would it intervene. And even though the Commission has argued that there is no difference between determining "reasonable" rates or identifying "unreasonable" rates, giving deference to upper tier decisions by local authorities, absent some "unreasonable" situation, would certainly be in accord with

a more literal, if not accurate, reading of the Cable Act.

Under the Cable Act the Commission is to determine whether upper tier rates are unreasonable based on various enumerated factors, including the rates for similarly situated cable systems; the rates for systems, if any, that are subject to effective competition; the rate history of the system; the rates, as a whole for all cable services on the system; and the capital and operating costs of the system, including the quality and costs of customer service. If there is a thrust to these factors, it is that the system as a whole is to be examined -- its history, costs and services. Upon complaint the Commission can determine that the local franchising authority, in the best position to judge these factors, has taken them into consideration. And, indeed, under alternative regulation this would be the case. Traditionally, local franchising authorities compare rates and services with those in similar, nearby communities. The local franchising authority is most sensitive to the level and quality of service, including customer service. Actually, the factors to be used to determine whether upper tier rates are unreasonable are <u>more</u> within the experience of the local franchising authority than those to determine the reasonableness of basic tier rates. Under these circumstances, the Commission can fulfill its statutory responsibility merely by exercising oversight.